CBO STAFF MEMORANDUM

THE EFFECTS OF PROPOSED MODIFICATIONS
TO THE PELL GRANT PROGRAM IN
S. 1150 AND H.R. 3553

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PREFACE

The Congress is currently reauthorizing the Higher Education Act. In response to a request by Senator Pete V. Domenici, Ranking Republican Member of the Senate Committee on the Budget, this staff memorandum compares the Pell Grant provisions contained in S. 1150, as passed by the Senate; H.R. 3553, as ordered reported by the House Committee on Education and Labor; and the current program. In accordance with the Congressional Budget Office's mandate to provide objective and impartial analysis, the memorandum contains no recommendations.

Constance Rhind of the Human Resources and Community Development Division prepared the memorandum under the direction of Nancy Gordon and Bruce Vavrichek. The author gratefully acknowledges the contributions of Susan Boren, Deborah Kalcevic, Jay Noell, Janice Peskin, and Ralph Smith. Eric Guille provided extensive computer assistance in modelling the Pell Grant program. Julia Jacobsen and Jacquelyn Vander Brug also provided computer assistance. Roger Williams edited the manuscript. Ronald Moore and Jill Bury provided administrative assistance and prepared the manuscript.

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The Pell Grant program will provide $5.5 billion to an estimated 3.6 million needy undergraduate students this year. It is the federal student-aid program most targeted toward low-income students. The Congress is currently reauthorizing the Higher Education Act, including the legislation for Pell Grants. This staff memorandum compares and contrasts the Pell Grant provisions in S. 1150, as passed by the Senate, and H.R. 3553, as ordered reported by the authorizing committee, with the current program.[1]

The provisions in H.R. 3553 would make greater changes in the program than would those in S. 1150. Reflecting these differences, the total cost of the Pell Grant program under H.R. 3553 would be an estimated $12.6 billion in 1993, with an expected 4.8 million recipients.[2] In the same year, the total cost of the program under S. 1150 would be an estimated $8.5 billion, and it would provide awards to about 4.2 million recipients.

DESCRIPTION OF THE PELL GRANT PROGRAM

Students' eligibility for Pell Grants and the size of their awards depends on three factors: the amount they and their families are expected to contribute to their education, the cost of attendance, and whether the students attend

1. The last part of this memorandum details these differences, and Appendix Table 1 summarizes them.

2. All years are fiscal years unless otherwise noted. All costs are budget authority.

part time or full time. The Higher Education Act specifies formulas to calculate the expected family contributions (EFCs); these formulas are collectively known as "need analysis." The EFC is determined by what is essentially a progressive tax formula. In effect, need analysis "taxes" family incomes and assets above amounts assumed to be required for a basic standard of living. In so doing, it makes adjustments for such characteristics as family size, unusual medical expenses, the number of family members enrolled in postsecondary educational institutions, private elementary or secondary school tuition for the siblings of college students, and the amount of federal and state taxes paid.

Students' dependency statuses also influence their EFCs. For a dependent student, the EFC consists of both parental and student contributions. In contrast, the parents of an independent student are not expected to contribute to their children's educational costs. (The spouse of an independent student, however, is expected to contribute.)

An independent student is one who meets <u>any</u> of the following criteria:

- at least 24 years old;
- a veteran;

- married and not declared a dependent on the parents' federal income tax return in the current year;

- has legal dependents other than a spouse; or

- single, not claimed as a dependent on the parents' income tax return in the previous two years, and had an income of at least $4,000 in each of those years.

All other Pell applicants are classified as dependent. About 65 percent of the program's current recipients are independent students.

The Pell Grant formula is used to determine the EFCs for students applying for Pell Grants. Another mechanism, known as the Congressional Methodology, is currently used in awarding Stafford Loans and federal campus-based aid. S. 1150 would modify the current Pell Grant formula to determine the eligibility of students for Pell Grants; H.R. 3553 would use a modified form of the Congressional Methodology. The Pell Grant formula and the Congressional Methodology are similar in concept but differ in some particular specifications.

Under both methodologies, the expected parental contribution for dependent students is based on the parents' income and assets. First, discretionary income is determined by allowing certain deductions from total income, including those for expenses that are required (such as federal and state taxes), necessary (basic living expenses), related to acquiring income (employment allowance), or unusual (medical expenses and private school tuition). Discretionary income is typically lower under the Congressional Methodology than under the Pell Grant formula; for example, the Pell Grant formula, unlike the Congressional Methodology, does not allow Social Security taxes to be deducted from total income. Second, both methodologies consider a portion of the parents' net assets deemed to be available to pay for postsecondary costs.

In the Pell Grant formula, separate "tax" schedules are applied to discretionary income and available assets, resulting in amounts that are added together to calculate the parental contribution to the EFC. The tax rate on discretionary income starts at 11 percent for amounts up to $5,000 and rises to 25 percent for amounts over $15,000. The rate on available assets is a flat 5 percent.

In contrast, under the Congressional Methodology, discretionary income is added to the so-called income supplement--that is, to 12 percent of the available assets--to determine the adjusted available income. A single tax schedule is then applied to this amount to determine the parents' contribution to the EFC. The tax rate rises from 22 percent for adjusted available incomes below $9,300 to 47 percent for those above $18,700. For the majority of applicants, the Congressional Methodology generates a higher EFC than the Pell Grant formula.

Educational costs also affect Pell awards. The allowed cost of attendance includes tuition and fees and an allowance for nontuition expenses. For the roughly 20 percent of current recipients who live with their parents, the 1992 nontuition allowance is $1,800 each year; for all other students, it is $2,400. The allowed cost of attendance therefore depends on the choices of students and their families: the choice of institution determines the level of tuition and fees; living at home or away from home determines the amount of the allowance for nontuition expenses.

After calculating a student's EFC and allowed cost of attendance, award levels are determined by choosing the lowest of the following three amounts:

- The maximum award minus the EFC;

- Sixty percent of the allowed cost of attendance; or

- The allowed cost of attendance minus the EFC.

Students whose awards are calculated to be less than $200 receive no grant, however. The first rule limits the award for about 80 percent of current recipients. The second rule affects roughly 20 percent of the recipients, mostly low-income students attending low-cost institutions; the third rule affects fewer than 1 percent of the recipients.

The maximum award for 1992 was set by the appropriations committees at $2,400. As a result, only students whose EFCs are lower than $2,200--the $2,400 maximum award minus the $200 minimum award--are eligible to receive a Pell Grant. That generally corresponds to a family income of below $35,000 or so for dependent students and below $20,000 or so for independent students.

CHARACTERISTICS OF CURRENT PELL GRANT RECIPIENTS

As a result of the rather stringent eligibility and award rules, most Pell recipients have low family incomes. An estimated 72 percent of independent recipients' incomes fall at or below $10,000 (see Table 1). Of those, most

TABLE 1. ESTIMATED DISTRIBUTION OF PELL GRANT RECIPIENTS BY DEPENDENCY STATUS, ADJUSTED GROSS INCOME, AND EXPECTED FAMILY CONTRIBUTION, 1992 (In percent)

Expected Family Contribution	Adjusted Gross Income[a] $0-$10,000	$10,001-$25,000	$25,001-$40,000	$40,001 and Over	All
		Independent			
$0	63	4	b	b	67
$1 - $500	4	9	b	b	13
$501 - $1,000	3	5	1	b	9
$1,001 - $2,200	3	4	4	b	11
All	72	22	6	b	100
		Dependent			
$0	27	7	b	b	33
$1 - $500	6	14	2	b	22
$501 - $1,000	1	9	5	b	16
$1,001 - $2,200	1	9	14	5	29
All	36	39	20	5	100

SOURCE: Congressional Budget Office estimates.

a. The adjusted gross income is that income calculated in determining federal income taxes.

b. Fewer than 0.5 percent.

have financial conditions that result in EFCs of zero--that is, they are not expected to contribute anything toward their educations. An additional 22 percent of independent recipients have incomes between $10,001 and $25,000. Because dependent students and their parents generally have higher incomes and more assets than do independent students and their spouses, dependent students are generally expected to contribute considerably more, and their calculated need for aid is correspondingly less. An estimated 36 percent of all dependent recipients have family incomes at or below $10,000 and 76 percent have family incomes at or below $25,000.

Lower EFCs generally correspond to higher Pell awards. For example, independent recipients who are not expected to contribute toward their educations receive an average award of $1,720, while those who are expected to contribute between $1,001 and $2,200 receive an average award of $680 (see Table 2).[3] The overall average award for an independent recipient is roughly $1,540. The average award for dependent recipients is $1,480: $1,860 for those who are not expected to contribute to their educations and $750 for those who are expected to contribute more than $1,000.

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3. The differences in the average awards by cell for independent and dependent recipients stem primarily from differences in the attendance status of these recipients. When the averages are calculated for full-time, full-year recipients, the average awards by cell of dependent recipients are closer to those of independent recipients--as shown in Appendix Table 2. The remaining differences in the averages by cell are attributable primarily to differences in the allowable cost of attendance.

TABLE 2. ESTIMATED AVERAGE PELL GRANT AWARD BY DEPENDENCY STATUS, ADJUSTED GROSS INCOME, AND EXPECTED FAMILY CONTRIBUTION, 1992 (In dollars)

Expected Family Contribution	Adjusted Gross Income: $0- $10,000	$10,001- $25,000	$25,001- $40,000	$40,001 and Over	All
Independent					
$0	1,720	1,720	a	a	1,720
$1 - $500	1,650	1,540	a	a	1,570
$501 - $1,000	1,280	1,200	1,160	a	1,220
$1,001 - $2,200	820	640	640	a	680
All	1,670	1,320	790	a	1,540
Dependent					
$0	1,850	1,900	a	a	1,860
$1 - $500	1,910	1,830	1,780	a	1,850
$501 - $1,000	1,470	1,470	1,460	a	1,470
$1,001 - $2,200	800	840	730	610	750
All	1,810	1,520	990	660	1,480

SOURCE: Congressional Budget Office estimates.

a. Sample size is too small to estimate the average award reliably.

Pell recipients, as shown in Table 3, attend schools in the following proportions: 60 percent, public schools; 18 percent, private schools; and 23 percent, proprietary schools. (Proprietary schools are private, for-profit institutions that typically provide job training.) These shares differ for dependent and independent recipients, however. Dependent recipients are more likely to attend private colleges than independent recipients and less likely to attend proprietary schools. Roughly the same percentage of both groups attends public colleges.

While the vast majority of recipients attend postsecondary schools full time, a sizable minority of independent recipients attend school part time (see

TABLE 3. ESTIMATED DISTRIBUTION OF PELL GRANT RECIPIENTS, BY TYPE OF INSTITUTION AND DEPENDENCY STATUS, 1992 (In percent)

Type of Institution	Dependency Status		
	Dependent	Independent	Combined
Public	64	57	60
Private	25	14	18
Proprietary	12	29	23
All	100	100	100

SOURCE: Congressional Budget Office estimates.

TABLE 4. ESTIMATED DISTRIBUTION OF PELL GRANT RECIPIENTS, BY ATTENDANCE AND DEPENDENCY STATUS, 1992 (In percent)

	Dependency Status		
Attendance Status	Dependent	Independent	Combined
Full Time	90	71	78
Three-Quarter Time	3	7	5
Half Time	8	22	17
All	100	100	100

SOURCE: Congressional Budget Office estimates.

Table 4). Most of the part-time recipients attend half time. Funding has not been appropriated for less-than-half-time students in any year except 1989.

A COMPARISON OF S. 1150 AND H.R. 3553 WITH THE CURRENT PROGRAM

Equal educational opportunity has been defined as meaning that limited financial resources should not deny aspiring students access to a postsecondary education, some choice among institutions charging different levels of tuition and fees, or the ability to continue their educations. Pell Grants promote this opportunity by reducing the amounts that students and their families pay for postsecondary education.

An Overview

Both S. 1150, as passed by the Senate, and H.R. 3553, as ordered reported by the authorizing committee, address these goals by raising the maximum award and by changing the rules that determine the size of the awards, thus greatly expanding the amount of aid that would be provided. For example, both bills would exclude house and farm equity from financial resources for at least some families. They would also permit financial aid administrators at postsecondary institutions to exercise discretion in setting awards, and would allow at least some less-than-half-time students to receive Pell Grants. Operating in the opposite direction, however, both bills would tighten the definition of independent students.

The two bills differ in a number of respects, such as maximum awards, methods used to calculate awards, and several components of need analysis. H.R. 3553 would provide an additional deduction from available income for parents of dependent students with substantial family savings. The last part of this memorandum details the bills' major differences, and Appendix Table 1 summarizes them.

The Pell awards that several sample applicants would receive under the current program, S. 1150, and H.R. 3553 are shown in Table 5. While all of

TABLE 5. ILLUSTRATIVE PELL AWARDS FOR APPLICANTS UNDER THE CURRENT PROGRAM, S. 1150, AND H.R. 3553

	Current Program (Maximum Award $2,400)	S. 1150 (Maximum Award $3,600)	H.R. 3553 (Maximum Award $4,650)
Dependent Student			
Parental Income of $10,000 with No Assets	2,400	3,600	4,650
Parental Income of $20,000 with No Assets	1,800	3,000	4,650
Parental Income of $20,000 with House Equity of $50,000	800	3,000	4,650
Parental Income of $40,000 with House Equity of $50,000	0	0	2,010
Single Independent First-Year Student			
Income of $10,000 with No Assets	690	2,460	1,500

SOURCES: Congressional Research Service, "The Pell Grant Formula and Need Analysis: A Computer Assisted Comparison of Current Law, Senate, and House Alternatives," forthcoming; and Congressional Budget Office calculations.

NOTE: Students are assumed to attend schools with tuition of $7,000.

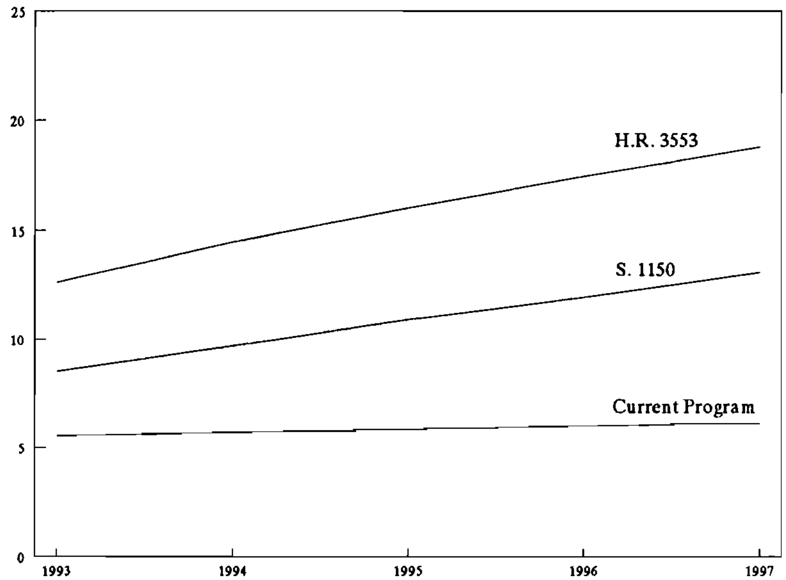
the differences in awards that result from the two bills cannot be demonstrated in a small number of examples, some of the variation can be highlighted. For instance, dependent students with parental income of $20,000 would receive about $1,200 more under S. 1150 than under the current program if they had no assets and about $2,200 more than under the current program if they had house equity of $50,000; both of these types of students would receive much larger awards under H.R. 3553. An independent student with income of $10,000 would receive an award of $690 under the current program, $2,460 under S. 1150, but only $1,500 under H.R. 3553.

Analyses of S. 1150 and H.R. 3553 indicate overall that in 1993 both proposals would substantially increase the estimated costs and the number of recipients above those of the current program.[4] The estimated total cost of the Pell Grant program under S. 1150 would be $8.5 billion in 1993, rising to $13.0 billion in 1997 (see Figure). The estimated total cost of the Pell Grant program under H.R. 3553 would increase from $12.6 billion to $18.8 billion over this period. The single most important provision in explaining the projected costs of these bills is the proposed increase in the maximum award levels. Other modifications, such as no longer taxing house and farm equity and tightening the definition of independent students, would also have

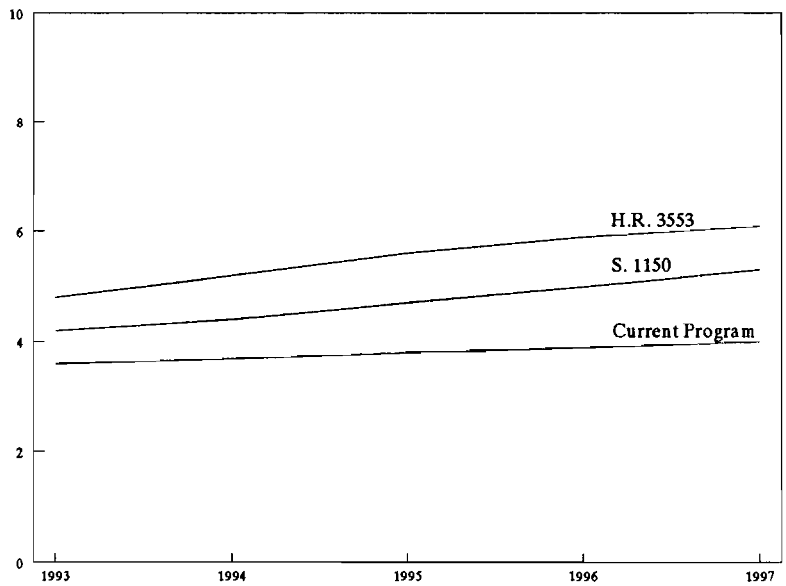
4. For purposes of comparison, the current program is assumed to reflect a constant maximum award of $2,400 and a growth in applicants of about 4.2 percent each year.

Figure.
Estimated Total Program Cost and Number of Pell Grant Recipients Under the Current Program, S. 1150, and H.R. 3553, 1993–1997

Total Program Cost (In billions of dollars of budget authority)



Number of Recipients (In millions)



SOURCE: Congressional Budget Office estimates.

NOTES: Under H.R. 3553, the maximum award is estimated to be $4,650 in 1993, and it rises at the rate of inflation thereafter to an estimated $5,400 in 1997. Under S. 1150, the maximum award is $3,600 in 1993, and it rises $200 each year thereafter. The maximum award under the current program estimate is $2,400 each year.

See Appendix Table 3 for additional information.

significant impacts. About two-thirds of the new spending under either bill would go to the same recipients as under the current program in the form of larger awards; the remaining one-third would go to new recipients (see Table 6).

Because newly eligible students would generally have more financial resources than currently eligible ones, new recipients would receive smaller awards than current recipients under both bills. For example, the estimated average award for independent students under S. 1150 would be $2,130 for

TABLE 6. ESTIMATED ADDITIONAL SPENDING ON PELL GRANTS UNDER S. 1150 AND H.R. 3553, 1993

	S. 1150		H.R. 3553	
	In billions of dollars	In percent	In billions of dollars	In percent
Total Increase in Spending Over Current Program[a]	3.0	100	7.1	100
Recipients Under the Current Program	2.0	67	4.5	63
New Recipients	1.0	33	2.6	37

SOURCE: Congressional Budget Office estimates.

a. These estimates exclude students who would not be eligible for a grant under S. 1150 or H.R. 3553 but who would have received an award under the current program.

those who would receive an award under the current program, compared with $1,200 for new recipients (see Table 7). A similar pattern would hold for dependent students under S. 1150 and for both types of recipients under H.R. 3553. Because the maximum award under H.R. 3553 is higher, its average awards are substantially higher.

Most of the increase in the number of recipients under S. 1150 would be dependent students. The bill would increase the estimated number of independent recipients by only about 30,000, compared with about 530,000 new dependent recipients (see Table 8). In contrast, the estimated 1.2 million additional recipients under H.R. 3553 would be split about evenly between independent and dependent recipients. The difference in the distribution of new recipients between the bills occurs because H.R. 3553 would generally require independent students to pay the same amount or less toward their educations than would S. 1150. Conversely, S. 1150 would generally require dependent students to pay the same amount or less as would H.R. 3553.

Although both bills would allow many more students to receive Pell Grants, S. 1150 would allow more recipients with incomes between $10,001 and $40,000, and H.R. 3553 would allow more recipients with incomes above and below this range. For example, the estimated number of dependent recipients with incomes between $10,001 and $40,000 would be 740,000 under

TABLE 7. ESTIMATED AVERAGE AWARDS FOR PREVIOUS AND NEW PELL GRANT RECIPIENTS, BY DEPENDENCY STATUS, 1993 (In dollars)

	Current Program (Maximum Award $2,400)	S. 1150 (Maximum Award $3,600)	H.R. 3553 (Maximum Award $4,650)
	Independent		
Recipients Under the Current Program	1,540[a]	2,130	2,800
New Recipients	n.a.	1,200	2,120
All Recipients	1,540[a]	2,080	2,710
	Dependent		
Recipients Under the Current Program	1,480	2,170	2,830
New Recipients	n.a.	1,120	1,620
All Recipients	1,480	1,960	2,550

SOURCE: Congressional Budget Office estimates.

NOTE: n.a. = not applicable.

a. Estimates of the current program include only those independent students who still qualify as independent under S. 1150 and H.R. 3553.

TABLE 8. ESTIMATED PELL GRANT RECIPIENTS BY DEPENDENCY STATUS AND ADJUSTED GROSS INCOME, 1993

	Adjusted Gross Income				
	$0- $10,000	$10,001- $25,000	$25,001- $40,000	$40,001 and Over	All
		Number of Recipients (In thousands)			
		Independent			
Current Program	1,710	500	120	10	2,330
S. 1150	1,450	650	220	40	2,360
H.R. 3553	2,080	580	140	70	2,870
		Dependent			
Current Program	480	480	260	70	1,280
S. 1150	500	580	500	230	1,810
H.R. 3553	530	570	460	350	1,900
		Percentage Distribution			
		Independent			
Current Program	73	21	5	a	100
S. 1150	62	27	9	2	100
H.R. 3553	73	20	5	2	100
		Dependent			
Current Program	37	38	20	5	100
S. 1150	28	32	28	12	100
H.R. 3553	28	30	24	18	100

SOURCE: Congressional Budget Office estimates.

a. Fewer than 0.5 percent.

the current program, 1.1 million under S. 1150, and 1.0 million under H.R. 3553; the estimated number of dependent recipients with incomes above $40,000 would increase from 70,000 to 230,000 under S. 1150 and to 350,000 under H.R. 3553.[5]

Uncertainty in Estimated Growth

Considerable uncertainty surrounds the estimates of the numbers of recipients under the two bills. Except during the first few years of program operation, when both schools and students were learning the system, the Pell Grant program has never had as substantial an increase in eligibility as the bills would provide. The estimates given in this staff memorandum are based on assumptions about increases in recipients that would stem from four sources:

- Current applicants for a Pell Grant who would be newly eligible under the bills;

- Currently eligible applicants who would decide to attend school because they would receive greater awards;

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5. The estimated number of independent recipients with incomes below $10,000 would fall under S. 1150 because the tighter definition of an independent student would not be offset by the corresponding changes in the EFC under H.R. 3553.

- New students who would apply for aid because of the increased awards and greater eligibility; and

- Current students who would apply for aid because of the increased awards.

The first source of growth is expected to be the largest. In 1993, roughly 60 percent of the estimated increase in recipients in S. 1150 and about 45 percent of the increase in recipients in H.R. 3553 would be attributable to current applicants for a Pell Grant who would be newly eligible.

The remaining increase is attributable to the other three sources of growth. The number of currently eligible applicants who would newly attend school--the second source--would also be expected to increase substantially. At present, about 74 percent of eligible independent applicants and 85 percent of dependent applicants receive awards.[6] For each percentage point increase in these rates, roughly 50,000 additional students would receive awards.

Both bills would be expected to increase the number of people attending college, including some who have never applied for aid. Each 1 percent increase in the number of new students represents more than 100,000

6. Because these are grants, those who are eligible but do not receive awards presumably do not attend school.

potential recipients. Presumably all new students induced to enroll because of changes in the program would receive awards. One likely source would be the roughly 25 percent of first-year students who do not now continue to their second year. Each 1 percentage point drop in this rate would raise the number of recipients by roughly 25,000.

Many current students appear to be eligible for, but not to apply for, Pell Grants. Some of these students would be expected to apply for aid if either bill became law because their anticipated awards would be larger.

The last three effects would be expected to grow over time, perhaps substantially, as students and schools learned about the increased generosity of the program. As a result of these effects, the estimated number of Pell recipients would grow by about 1.1 million between 1993 and 1997 if S. 1150 becomes law and by about 1.3 million if H.R. 3553 becomes law.

Both bills would also expand students' choices in selecting postsecondary institutions. To the extent that Pell recipients chose to attend higher-cost schools, that effect would lead to higher program costs. The bills might also encourage some schools to raise their tuitions and fees to capture some of the additional federal aid. That outcome would be most likely at institutions--including some proprietary schools--with a high proportion of students receiving Pell Grants. The increase in choice (and in schools raising their tuitions) would raise the cost of the program by an estimated 3 percent under either bill.

The remainder of this staff memorandum considers the major components of the bills in greater detail.

Award Levels

In 1993, S. 1150 would raise the maximum award level to $3,600, and H.R. 3553 would raise it to an estimated $4,650. Thereafter, S. 1150 would increase the maximum award by $200 each year, reaching $4,400 in 1997; H.R. 3553 would raise it at the rate of inflation, reaching an estimated $5,400 in 1997.

The minimum award level would be $400 under both bills. Students eligible for awards of between $200 and $399 would receive $400 under S. 1150 but would receive no award under H.R. 3553. Allowing students eligible for awards of between $200 to $399 to receive awards of $400, as in S. 1150, would create a "notch" in the award level: students judged to be somewhat financially more able to pay for postsecondary school would receive the same awards as those who are considered less able to pay.[7]

Raising the maximum award level would reduce the cost of education for many current and potential students, thereby increasing their access to higher education. It would also afford students more flexibility of choice because they would have more funds available if they choose to attend more expensive schools. Under S. 1150, all applicants who are expected to pay less than $3,400 toward their educations (generally dependent students with family incomes below $40,000 or so and independent students with incomes below $25,000 or so), could receive an award, compared with the current threshold of $2,200.[8] Using the tables in H.R. 3553, the EFC threshold would be $7,400 for dependent students (generally those with family incomes below $55,000 or so) and $5,200 for independent students (generally those with incomes below $25,000 or so).

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7. A notch already exists in the current program in that students currently eligible for awards of $199 or less receive no award.

8. The applicants with EFCs below the current threshold are generally dependent students with family incomes below about $35,000 and independent students with incomes below $20,000 or so.

Award Rules

S. 1150 would simplify the rule used to award Pell Grants. In 1993, an eligible applicant's award would be determined by adding a $2,300 basic educational allowance to the smaller of $1,300 or 25 percent of the tuition and fees, then subtracting the applicant's EFC.[9] Thus, for example, recipients with EFCs of zero who attend schools with tuitions of $5,200 or more would receive the maximum award of $3,600 in 1993. Thereafter, S. 1150 would increase the basic educational allowance by $128 each year, and the maximum allowed from tuition by $72 each year, for a total increase of $200 annually.

Under H.R. 3553, Pell Grants would be determined using tables based on the dependency status, tuition and fees, and EFC of the applicants. For example, recipients who are not expected to pay anything toward their education, and who attend schools with tuitions greater than $7,200, would receive the estimated maximum of $4,650. As the maximum award increased with inflation, the amount of students' awards would rise by 50 percent of the

9. Students with dependent care expenses or disability-related expenses would receive a basic educational allowance of $3,000 in 1993.

increase in the maximum if their tuition and EFC remained within the same range.[10]

Simplifying the award structure, as in S. 1150, would make it more sensitive to the recipients' tuitions. Having one educational allowance for all recipients, however, would benefit students living with their parents.[11]

It is difficult to draw general conclusions about the impact of the tables used in H.R. 3553 because no simple formulas underlie them.

Making the Pell Grant Program an Entitlement

The current Pell Grant program is classified as part of domestic discretionary federal spending. H.R. 3553 would change this budgetary treatment to make the program an entitlement beginning in 1993. The shift could have significant implications for future spending in the program.

10. Recipients who receive the maximum award (and whose tuition and EFC remain within the same range) might have their awards increased by slightly more than this amount.

11. Currently, students living with their parents receive a lower allowance to reflect their lower expenses.

The Budget Enforcement Act, part of the Omnibus Budget Reconciliation Act of 1990, sets rules for federal spending between now and 1995.[12] Under these rules, the implicit trade-off between spending in discretionary programs and entitlements has been affected because each spending category has special limitations. Discretionary spending is subject to annual dollar limits, or caps, between 1993 and 1995, including a specific cap on domestic discretionary spending in 1993. Legislative expansions in entitlements and other mandatory spending are restricted by "pay-as-you-go" budgetary rules. One entitlement program can generally be expanded only if others are cut or if taxes or fees are raised, except where emergencies are involved.

Because H.R. 3553 would make the Pell Grant program an entitlement in 1993, this change would be affected by the Budget Enforcement Act. The procedures for moving the spending are unclear. Even so, two major possibilities appear to exist.

One possibility is that the discretionary caps would remain unchanged and pay-as-you-go limitations would not be relaxed. In this case, the entire Pell Grant program would need to be paid for by increasing revenues,

12. For a thorough discussion of the budget process, see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1993-1997* (January 1992), Chapter 2.

decreasing other entitlements, or through a sequestration of other mandatory programs.

A second possibility might arise if the legislation were to specify a different outcome: that the cap on discretionary spending would be reduced by the amount of Pell Grant spending, and that that amount would then be allowed to increase total mandatory spending without triggering pay-as-you-go restrictions. If that were to happen, the domestic discretionary cap would be reduced by the baseline projections in 1993, and the larger cap on all discretionary spending would be reduced by the baseline amounts in 1994 and 1995.[13] Any additional spending on Pell Grants before 1996 would need to be paid for by increasing revenues or decreasing other mandatory spending (perhaps through sequestration).

In any case, the shift from discretionary to mandatory would have several impacts on the Pell Grant program. The authorizing, rather than appropriations, committees would set the maximum award. Currently, the authorizing committees design the program and establish the maximum award; but because the program is now part of discretionary spending, the appropriations committees have the authority to modify it to keep spending

13. The baseline estimates would change--reflecting the differences in the way baseline estimates are calculated for entitlement and discretionary programs--while the estimates for programmatic options would remain the same.

within their limits. In the past, the appropriations committees have changed the maximum award and have also adjusted other parts of the program, such as eliminating less-than-half-time students from eligibility and limiting the discretion of financial aid administrators to change Pell awards.

Making the Pell Grant program an entitlement would also facilitate planning by current and future applicants and schools because they would know the level of the maximum award well in advance. That amount would not be reduced because of the funding constraints of the appropriations committees. Removing the discretionary nature of the program, however, would reduce the immediate flexibility of the Congress to limit its spending. As an entitlement, the cost of the Pell Grant program might not be given the annual scrutiny it would receive if it continued to be discretionary, in which case spending would be set specifically for each year.

Need Analysis

S. 1150 would use a modified version of the current Pell Grant formula in assessing families' ability to pay, and H.R. 3553 would use a modified version of the Congressional Methodology. Modifications of these methodologies would include tightening the definition of independent students, limiting the inclusion of house and farm equity as "taxable" assets, extending the simplified needs test, and adding an allowance to promote educational savings.

Definition of Independent Students. Both bills would tighten the definition of an independent student. Under the new rules, an independent student would be one meeting any of the following criteria:

- o at least 24 years old;
- o a veteran;
- o married; or
- o having legal dependents other than a spouse.

It would not include a category of students now classified as independent: single students who were not claimed as a dependent by their parents for income tax purposes in the previous two years and who had incomes of at least $4,000 in each of those years.[14]

An estimated 25 percent of the students who would no longer be classified as independent would receive awards as dependent students under the two bills. Those students whose parents have few financial resources

14. Married students who were claimed as dependents on their parents' income tax returns in the current year are now considered dependent students; under both bills, all married students would be considered independent. This provision would affect only about 2,000 applicants.

would receive similar awards. Moreover, the effect on the enrollment of the remaining 75 percent who would no longer qualify for awards might be small because their parents presumably have the resources to help finance their educations. But some students whose awards would be cut or eliminated would not receive additional financial support from their parents. They might have to attend less costly schools, and some might not finish their educations. In addition, some students who are truly financially independent of their parents would receive less aid.

In 1993, exclusion of those students would affect an estimated 180,000 students in S. 1150, leading to estimated savings of over $400 million relative to the bill without that change. The same provision in H.R. 3553 would affect about 290,000 students, leading to estimated savings of just under $900 million. The number of students affected, and hence the estimated savings, would rise in future years with increases in the maximum award.

<u>House and Farm Equity</u>. House and farm equity is currently "taxed" at 5 percent after a deduction for the first $30,000 of house equity and the first $100,000 of farm equity. About 30 percent of the dependent applicants with family incomes under $50,000, and fewer than 5 percent of similar independent applicants, have house or farm equity greater than the current deductions.

S. 1150 would exclude this equity for families with incomes of $50,000 or less--almost 90 percent of the 1992 applicants. In 1993, the exclusion would increase the estimated total cost of the program by roughly $300 million if the simplified needs test discussed in the next section were also modified to reflect this change. That cost is expected to grow over time as more families with large house equity learn that they may be eligible for Pell Grants.

The effect of making the exclusion applicable only to those applicants with family incomes of $50,000 or less would be to create a notch for families with house equity: those with incomes just above the notch of $50,000 would be expected to pay substantially more toward their educations than those with incomes just below it. For example, applicants with house equity of $75,000 would be expected to pay $2,250 more if they have incomes just above the threshold than if they have incomes just below it. Other programs avoid this problem by phasing in the range over which equity may be excluded.

H.R. 3553 would eliminate house and farm equity from inclusion in need analysis for all families. About 35 percent of all dependent applicants and fewer than 5 percent of all independent applicants currently have house and farm equity greater than the deductibles. The exclusion in H.R. 3553 would increase the estimated total cost of the program by roughly $300 million in 1993 compared to the cost without this provision.

Those changes respond to the concern that the large increases in housing prices over the last decade have made it difficult for some families to pay the mortgage if they were to borrow against the equity in their house. But because the current program does not require the parents of dependent students to pay more than 5 percent of their equity toward postsecondary expenses in each year, that fear may be overstated. In addition, the families whose house has appreciated during this period are now financially better off than they would have been if they had not owned a house then; not counting this equity introduces an inequity between families who own a house and those who do not.

Simplified Needs Test. Regarding the consideration of assets in assessing need, the current program exempts applicants with family incomes of $15,000 or less who file a 1040A or 1040EZ income tax form, or who do not have to file a federal tax form. Applicants who opt for the simplified needs form do not have to provide information on house and farm equity, other assets (other real estate, financial investments, cash, savings accounts, and checking accounts), medical and dental benefits, or tuition for elementary and secondary students.

S. 1150 would extend this provision to all applicants with family incomes of $50,000 or less who do not have to file a 1040 form; it would also exclude the incomes of dependent students from family income for this test.[15] Because S. 1150 would already exclude house and farm equity for families with incomes of $50,000 or less, the simplified needs test would not have a separate impact on families who have only house and farm equity. Fewer than 5 percent of the current applicants with incomes of $50,000 or less have other assets above the deductible. If the bill continued to exclude house and farm equity for families with incomes below that level, the estimated total cost of extending the simplified needs test would be less than $100 million in 1993.

Under H.R. 3553, dependent applicants and independent applicants with children who have incomes below the earned income tax credit threshold rounded to the nearest $1,000 ($22,000 in 1992) and do not file a 1040 income tax form would not be required to make contributions toward their educations.[16] About 40 percent of these applicants have incomes below that threshold, and approximately 60 percent of them are currently not expected

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15. In addition, under S. 1150, applicants receiving Aid to Families with Dependent Children benefits would automatically be given EFCs of zero.

16. Under H.R. 3553, an independent applicant who files (or a dependent applicant whose parents file) a 1040 income tax form is excluded from using the simplified needs test. In contrast, S. 1150 allows anyone who could file the shorter forms (or who does not have to file) to use the simplified needs test.

to pay anything. The estimated cost of this version of the simplified needs test would be roughly $650 million in 1993.

Not having to value assets would streamline the application process for most families. It would, however, create an inequity--similar to that discussed in the preceding section--in the treatment of families with incomes just above and just below the thresholds.

Educational Savings Protection Allowance. H.R. 3553 would provide a potential new deduction from income for parents of dependent students. Parents with positive net worth after the deductions for assets would be given an allowance to encourage them to save for their children's educations. This allowance would vary positively with their incomes; for example, it would average about $1,300 for parents with incomes of about $10,000 who are eligible for this deduction, compared with roughly $6,700 for parents with incomes of about $50,000. The estimated total cost of the provision would be less than $100 million in 1993.

The allowance would encourage parents to save for postsecondary education by taxing less of their income if they have substantial assets. It would, however, reduce the amount that wealthier families would be expected to pay relative to poorer families.

Discretion of Financial Aid Administrators

The authorizing language for the current Pell Grant program allows financial aid administrators at postsecondary schools to exercise discretion in setting students' EFCs as long as they document their reasons. This discretion has not been funded by the appropriations committees in any year except 1988. That year, the total cost of the provision was determined to be $33 million, and it affected nearly 100,000 recipients. About 75 percent of the increase in cost, most of which took place at public schools, was attributable to financial aid administrators using the projected year's income instead of the prior year's income in the need analysis. Perhaps surprisingly, some administrators also used their discretion to limit the awards or eligibility of some students. Both S. 1150 and H.R. 3553 would allow for discretion by financial aid administrators in general as it is specified in the authorizing language of current law. The total cost of this provision would be an estimated $40 million to $60 million annually, depending on the number of Pell Grant recipients in each year.

This discretion would allow financial aid administrators to use their professional judgment to deal with unusual circumstances that were not addressed by need analysis. Allowing the administrators flexibility to change awards, however, might mean that applicants in similar circumstances who attend different schools would be treated differently.

Eligibility for Less-Than-Half-Time Students

Students with EFCs of less than $200 who attend school less than half time are currently authorized to receive awards, but this provision was only funded in 1989 when less-than-half-time students had to have EFCs of zero. Fewer than 2,000 such students were awarded grants in that year. S. 1150 would allow less-than-half-time students who are expected to pay $200 or less toward their educations to receive Pell awards, and H.R. 3553 would allow all who are eligible to receive awards.

Of the estimated 3.4 million less-than-half-time undergraduate students today, an estimated 15 percent would have to pay $200 or less under the Pell Grant need analysis. Based on the experience of the program in 1989, however, the estimated total costs of these provisions would be small in the first year--$10 million for S. 1150 and $15 million for H.R. 3553. The estimated total costs would rise rapidly thereafter as schools and current and potential students became aware of the expanded availability of aid.

Allowing less-than-half-time students to receive awards would recognize that many people are only able to obtain a postsecondary education on a part-time schedule. It might, however, encourage students to take longer to earn their degrees.

APPENDIX

TABLE A-1. A COMPARISON OF THE CURRENT PROGRAM, S. 1150, AND H.R. 3553

Current Program	S. 1150	H.R. 3553
	Award Levels	
The appropriations committees set the maximum award at $2,400 in 1992.	Maximum award would be authorized at $3,600 in 1993 and would increase by $200 in each subsequent year. By 1997, the maximum award would be $4,400.	Estimated maximum award would be $4,650 in 1993 and would increase at the rate of inflation each year. By 1997, the projected maximum award would be $5,400.
Minimum award is $200.	Minimum award would be $400. Students who would have received between $200 and $399 would receive $400.	Minimum award would be $400.
	Award Rules	
Awards are determined by choosing the lowest of the following three calculations: o The maximum award minus the expected family contribution (EFC); o 60 percent of the cost of attendance; or o The cost of attendance minus the EFC.	Awards would be determined by adding a $2,300 basic educational allowance to the lesser of: o 25 percent of the tuition, or o $1,300 and subtracting the EFC.	Awards would be determined using tables based on the dependency status, tuition, and EFC of the applicant.

(Continued)

TABLE A-1. (Continued)

Current Program	S. 1150	H.R. 3553
Entitlement or Discretionary Spending		
Discretionary spending.	Discretionary spending.	An entitlement beginning in 1993.
Need Analysis		
Pell Grant formula.	Modified Pell Grant formula.	Modified Congressional Methodology.
Definition of an Independent Student		
An independent student is one meeting any of the following criteria: o at least 24 years old; o a veteran; o married and not declared a dependent on the parents' federal income tax return in the current year; o has legal dependents other than a spouse; or o single, not claimed as a dependent on the parents' income tax return in the previous two years, and had an income of at least $4,000 in each of those years.	An independent student would be one meeting any of the following criteria: o at least 24 years old; o a veteran; o married; or o having legal dependents other than a spouse.	An independent student would be one meeting any of the following criteria: o at least 24 years old; o a veteran; o married; or o having legal dependents other than a spouse.

(Continued)

TABLE A-1. (Continued)

Current Program	S. 1150	H.R. 3553
	Treatment of House and Farm Equity	
Taxed at 5 percent after first $30,000 of house equity and first $100,000 of farm equity.	Would not be included in need analysis for families with adjusted gross incomes (AGIs) of $50,000 or less. Same as current program for other families.	Would not be included in need analysis for any family.
	Simplified Needs Test	
Applicants who have family incomes of $15,000 or less and who file a 1040(A) or 1040(EZ) income tax form or are not required to file are exempt from having their assets considered in assessing need.	Applicants with family incomes (excluding a dependent student's income) below $50,000 who do not have to file a 1040 income tax form would be exempt from having their assets considered in assessing need. Applicants receiving AFDC would have their EFCs set at zero.	The parents of dependent applicants and independent applicants with dependent children who file 1040 income tax forms and whose family incomes fall below the rounded earned income tax credit threshold ($22,000 in 1992) would have their EFCs set at zero.

(Continued)

TABLE A-1. (Continued)

Current Program	S. 1150	H.R. 3553
	Deduction for an Educational Savings Protection Allowance	
No deduction.	No deduction.	Parents of dependent students whose net worth less the asset deduction is greater than zero would receive an "educational savings protection allowance" deduction that varies positively with their available income.
	Discretion for Financial Aid Administrators	
The authorizing language allows financial administrators to use their discretion in calculating students' EFCs. This discretion has been removed by the appropriations committees every year except 1988.	Would allow financial aid administrators to use discretion in calculating students' EFCs.	Would allow financial aid administrators to use discretion in calculating students' EFCs.
	Eligibility for Less-Than-Half-Time Students	
The authorizing language allows some less-than-half-time students to receive awards. This provision has been removed by the appropriations committees every year except 1989.	Less-than-half-time students with EFCs less than or equal to $200 would be eligible.	All less-than-half-time students would be eligible.

TABLE A-2. ESTIMATED AVERAGE PELL GRANT AWARD FOR FULL-TIME, FULL-YEAR RECIPIENTS BY DEPENDENCY STATUS, ADJUSTED GROSS INCOME, AND EXPECTED FAMILY CONTRIBUTION, 1992 (In dollars)

Expected Family Contribution	Adjusted Gross Income $0-$10,000	$10,001-$25,000	$25,001-$40,000	$40,001 and Over	All
		Independent			
$0	2,300	2,320	a	a	2,310
$1 - $500	2,100	2,110	a	a	2,110
$501 - $1,000	1,650	1,680	1,610	a	1,660
$1,001 - $2,200	1,050	810	850	a	880
All	2,220	1,780	1,070	a	2,070
		Dependent			
$0	2,240	2,240	a	a	2,240
$1 - $500	2,170	2,090	2,000	a	2,110
$501 - $1,000	1,670	1,650	1,620	a	1,640
$1,001 - $2,200	920	930	800	660	820
All	2,150	1,720	1,090	720	1,670

SOURCE: Congressional Budget Office estimates.

a. Sample size is too small to estimate the average award reliably.

TABLE A-3. ESTIMATES OF THE BUDGET AUTHORITY, OUTLAYS, NUMBER OF RECIPIENTS, AND MAXIMUM AWARD UNDER THE CURRENT PROGRAM, S. 1150, AND H.R. 3553, 1993-1997

	Current Program	S. 1150	H.R. 3553
	1993		
Budget Authority (billions of dollars)	5.53	8.49	12.59
Outlays (billions of dollars)	1.11	1.70	2.52
Number of Recipients (millions)	3.6	4.2	4.8
Maximum Award (dollars)	2,400	3,600	4,650
	1994		
Budget Authority (billions of dollars)	5.68	9.68	14.47
Outlays (billions of dollars)	5.45	8.56	12.72
Number of Recipients (millions)	3.7	4.4	5.2
Maximum Award (dollars)	2,400	3,800	4,825
	1995		
Budget Authority (billions of dollars)	5.82	10.86	16.03
Outlays (billions of dollars)	5.70	9.89	14.75
Number of Recipients (millions)	3.8	4.7	5.6
Maximum Award (dollars)	2,400	4,000	5,000
	1996		
Budget Authority (billions of dollars)	5.97	11.90	17.44
Outlays (billions of dollars)	5.85	11.05	16.28
Number of Recipients (millions)	3.9	5.0	5.9
Maximum Award (dollars)	2,400	4,200	5,175
	1997		
Budget Authority (billions of dollars)	6.12	13.04	18.78
Outlays (billions of dollars)	6.00	12.11	17.68
Number of Recipients (millions)	4.0	5.3	6.1
Maximum Award (dollars)	2,400	4,400	5,400

SOURCE: Congressional Budget Office estimates.